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8 July 1986

MEMORANDUM FOR: Associate Deputy Director for Intelligence

VIA: Director of Global Issues
Chief, Economics Division
Chief, Development Issues Branch

FROM: [redacted]
Development Issues Branch, Economics Division
Office of Global Issues

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SUBJECT: Request to Speak

1. I request permission to give an oral presentation on China's role in the international economy at a small private conference organized by the Office of Technology Assessment under the United States Congress. The presentation will be given on 28 July in the context of a meeting to discuss "China's Course to the Year 2000." I have addressed similar conferences in past years on this topic and have encountered no publicity problems.

2. This conference will provide a valuable forum for making contacts with members of the United States policymaking community. The conference will consist of ten to twenty US government employees and two or three individuals from outside the government.

3. None of the material to be used in the presentation is classified. No press personnel will be invited.

4. [redacted] I will be identified as an Agency employeee but will make the standard disclaimer indicating that the views expressed are my own and not necessarily those of the agency or the US Government.

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[redacted]

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SUBJECT: Request to Speak

[redacted]

for Division Chief — 8 July '86 Date

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Concur:

[redacted]

Director of Global Issues — 14 JUL 1986 Date

STAT

Approved:

Signed GF

for Associate Deputy Director of Intelligence — Date

SUBJECT: Request to Speak

OGI/ECD/DI/[redacted] 8 July86/[redacted] STAT

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Distrubution:

Original - Addressee
1 - D/OGI
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CHINA AND THE WORLD ECONOMY

I. China's Economic Expansion in Global Perspective
   A. China's "Open Door" Policy
      1. Beijing's Shift from Policy of Self-Reliance to Open Door has resulted in Export Growth Three Times the World Average
      2. China's Share of World Trade is Still Not Commensurate with its Share of World Output
   B. Sources of China's Past Export Growth
      1. China Began Export Drive From Small Share--No Threat to Anyone
      2. Growth in World Demand for the Commodities China Exported was Not a Major Factor
      3. China's Increasing Competitiveness Accounts for Two-Thirds of Export Growth
         a. Lowest Labor Costs--Rapid Growth in Labor Force
         b. Improvements in Quality
         c. Expanded Marketing Networks
         d. Low inflation rate
         e. Rapid increases in Productivity
   C. Potential For China's Future Export Growth
      1. China's Export to GNP Ratio Remains Below Normal for Country of China's Market Size, Per Capita Income, and Physical Accessibility--China Could Profit by Doubling Share of Trade
      2. China's Domestic Economic Productivity Remains Among the Lowest in World
         a. China Uses almost Twice as Much Energy Per Unit of Final Product as the rest of the World
         b. Inefficiencies Abound in terms of Converting Resources into Final Goods
         c. Economic Reforms and Growing Foreign Investment will Greatly Improve Productivity, Leading to even greater Capacity to Expand Exports
      3. Restraints on Export Growth
         a. Antiquated Transport System increases costs of expanding trade with Interior Provinces
         b. China's Exports are skewed towards Asia because of continuing lack of international marketing mechanism
         c. Lack of Incentives to take risks to develop new products or new markets
         d. Lack of Concern for Buyer's Needs as a result of operating for years in a supplier's market (consumers had no choice but to take what was offered)
         e. Overvalued exchange rate
   D. China's Trade Plans
      1. The Chinese have never announced their long range trade plans
         a. China's goal for domestic production calls for quadrupling output by the year 2000, implying a growth rate of 7.2 percent per year
         b. In order to avoid concrete discussions of their trade plans Chinese officials have alluded to their domestic production goals as an indicator of the magnitudes involved

- c. The Chinese may only have rudimentary long range trade plans because they do not have a clear idea of future import needs, export markets, or availability of financing

2. If China is to accomplish its long term economic goal trade would have to expand at a much faster rate than the domestic economy
3. Various trade agreements already signed plus occasional reports of export targets for specific industries, ports, and provinces suggest exports will grow at almost double the rate of the domestic economy
   - a. An overall growth rate of 10 to 15 percent per year is consistent with past trends
   - b. This is also consistent with the rate at which China has increased its penetration of foreign markets, independent of the growth in world demand
4. This projection assumes that China will maintain a cautious "open door" policy and does not abandon it in favor of a full-fledged policy of export promotion or to return to a policy of import substitution and self-reliance

E. China's Trade Policies

1. Although China's trade policies have changed dramatically from the autarkic years of Mao Zedong, contrary to much opinion, China has not pursued a totally open trade policy ala Taiwan or South Korea
   - a. Beijing continues to restrict foreignors' access to goods on the domestic market
   - b. Beijing has moved slowly on price reforms--a key condition to further liberalization of trade
   - c. Beijing continues to maintain tight controls on foreign exchange expenditures, the necessary result of an overvalued exchange rate
2. Beijing is currently debating whether China should pursue a policy of import substitution or export promotion
   - a. The debate stems from China's trade problems encountered in the past year--a massive trade deficit, declining oil prices, and declining terms of trade
   - b. China will have to give up increasing amounts of domestic resources if it is to get the imports it needs to modernize
   - c. Because of the major domestic ramifications of the issue the debate must be handled by China's political system
3. Initial indications are that China will try to push exports even harder
   - a. China will hold oil exports at current levels rather than cut back
   - b. All joint ventures--new and old--are now being required to earn sufficient foreign exchange from exports to cover not only their profit remittances but also their full import costs
   - c. Beijing is issueing import permits only for plant and equipment that produce goods for export--major infrastructural projects that do not generate foreign exchange are being cut

d. China's new willingness to take on substantial commercial debt is a indicator of Chinese intentions to sharply boost exports over the long run

II. Impact of China's Expansion on Other Countries

A. Major Growth Commodities

1. China's fastest growing exports in terms of market penetration include a range of light industry products, some crude minerals, some agricultural products, and petroleum based products. This is based on China's comparative advantage in either labor-intensive or certain resource-intensive lines
2. If China continues to penetrate markets at the same rate as it has since 1976, by 1990 China would account for 3 percent of world trade, and by 2000, 9 percent.
3. At 20 cents per hour, China's average wage rate is the lowest in East Asia and one of the lowest in the world
   a. Over the next five year plan (1986-1990) China must absorb nearly 100 million workers into its labor force--the equivalent of absorbing the entire US labor force
   b. Competition from China will tend to drive wages down in other LDCs
   c. China's ability to attract foreign investment will be great if Beijing can overcome some of the bureaucratic obstacles--China could drain foreign investment from other needy LDCs

B. China's Major Markets

1. China's greatest market penetration has been in the Asian region followed by the U.S., Brazil, Kuwait, and Jordan
2. West Europe has hardly been tapped
3. For most of these countries China only poses a threat in certain industries--not across the board

C. China's Major Competitors

1. China's greatest competition will come from the NICs, not the agricultural and resource oriented LDCs
2. In the area of light manufactures Taiwan and China stand above all others in terms of expanding their market presence
3. India, Mexico, Argentina, Thailand, and Hong Kong among China's competitors appear to have been most affected by China's advances in third country markets

D. Countries Whose Export Industries are Most likely to be Hurt

1. A handful of LDCs depend on the same group of commodities that China is targeting for a large share of their foreign exchange earnings. These include some of the poorest countries of Asia, Africa, and Latin America, as well as, Taiwan and Hong Kong.
2. On the other end of the spectrum are Malaysia and Mexico, which, although being major competitors, are not greatly dependent on the same commodities for a large share of foreign exchange earnings
   a. With the recent drop in oil prices, however, Mexico has just announced plans to expand production and exports of the same light manufacturers, a policy which is bound to drive Mexico into more intense competition with China
   b. Among Developed Countries, Italy, New Zealand, and

Australia are most dependent on the same type of goods that China exports for their own earnings

c. China will only be competitive with US export industries in corn, cotton, and a few other commodities, primarily in Asian markets

E. China's Fastest Growing Imports

1. China's fastest growing imports consist primarily of industrial supplies and capital goods, but in recent years a few consumer goods--televisions in particular--have made large advances
2. Some traditional imports have declined substantially as China switched from importer to exporter, e.g., cotton fiber, soybean oils, crude chemicals, and metalworking machinery
3. Imports have always been much more volatile than exports, making prediction of trade in the future more hazardous
4. China's import patterns actually appear closer to those of the developed countries
   a. China has a vested interest in keeping commodity prices low
   b. China probably stands to gain most on the import side by a system of free trade

III. Implications

A. The Balance of Winners and Lossers from China's Trade Expansion

1. For the global economic system as a whole there must be a net gain for trade to take place. As in every trade situation, however, there will always be winners and loosers, and any major advent, such as China's entry, will be marked by some severe dislocations.
2. In general, I believe the LDCs have most to loose from China's expansion, and the DCs the most to gain. China's economic interests are converging with those of the developed countries': in particular, the Chinese see "free trade" as in their interest.

B. China's Potential to Disrupt the Global Trade System

1. The potential for disruption is greater the more centralized China's economic system is
2. A more centralized system is able to:
   a. Concentrate resources (subsidizing industries)
   b. Link import and export decisions
   c. Change policies abruptly, resulting in instability
   d. Mask its intentions, making it more difficult to plan